BUSINESS CONSIDERATIONS

Understanding the ontractor's perspective

DAU South
Acquisition Update
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Business Considerations

- Strategic Planning
- Commercial vs Defense Contractors
- Government vs Industry View of Profit
- Cash is “KING”
- Importance of rates
- Industry motivators and incentives
- Challenges for Defense Contractors

STRATEGIC PLANNING

Strategic Planning

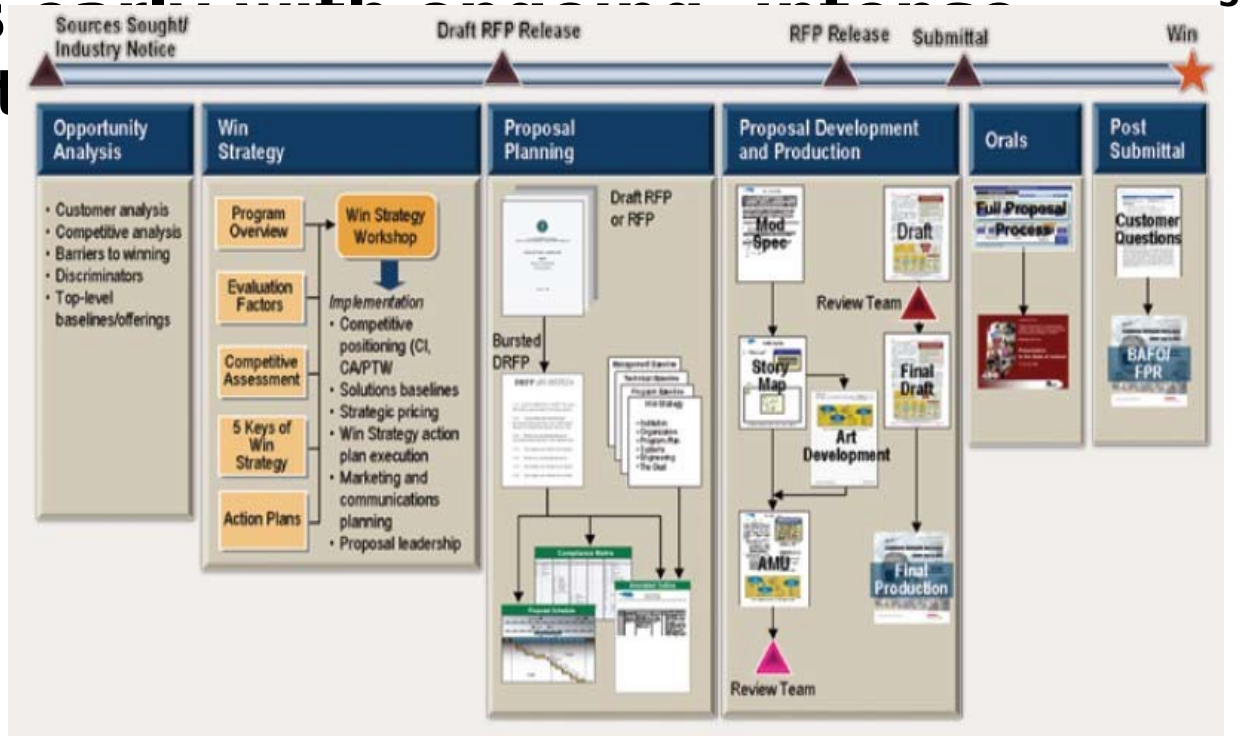
- Sales Planning Process & Forecasting
  - New Markets
    - International Market
    - Government Market
- Political Considerations
- Cyclical nature of defense budgets
- Macro Issues that Drives DoD Industry Today
- Long-term Vendor Agreements

New Markets

- **Market Strategy**
  - **Description**
  - **Company Core Capabilities**
  - **New Market Insertion**
  - **Opportunities, Competition, Strengths**
  - **Developing an Appropriate Business Model**
  - **Common Realities**
    - **Progressive Engagement**
    - **Current/New Business Trades**
  - **Risk Analysis and Return on Investment**

Program Capture

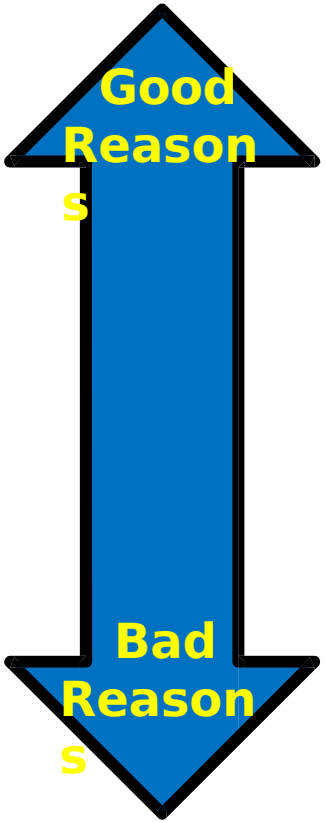
- **In Industry, Program Capture, Proposal Management and Contract Award/Program Execution are supporting processes**
- **Process starts early with ongoing intense analysis to det**
  - Risk
  - **Bid / No Bid**
  - **Program Staffing**
  - **Program Execution**
- **Phases overlap & support each other**
  - **Tight integration & execution of phases supports program execution**



[5] SM&A Website, "Competition Management" http://www.smawins.com/Competition_Mgmtbro_09June2009.pdf

Top Reasons for Bidding

Thou Shalt Bid

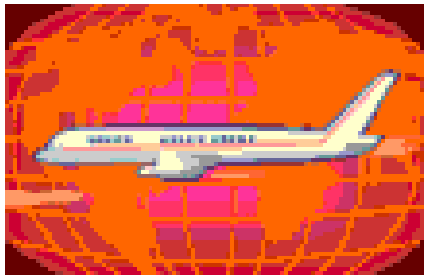


1. Profitability (make money)
2. Cash Flow
3. Sales and Earnings (backlog)
4. Strategic Positioning
5. New Technology/Markets
6. Balance Portfolio (risk)
7. Spread Overhead or Use Up Inventory

Implications of "Getting In"

- Companies must remain agile and dedicated to maintaining current markets as they break into new markets
- Drives the need for stepped up levels of efficiencies and maximizing the application of products across multiple markets
- Comprehensive and perpetual analysis of pertinent markets

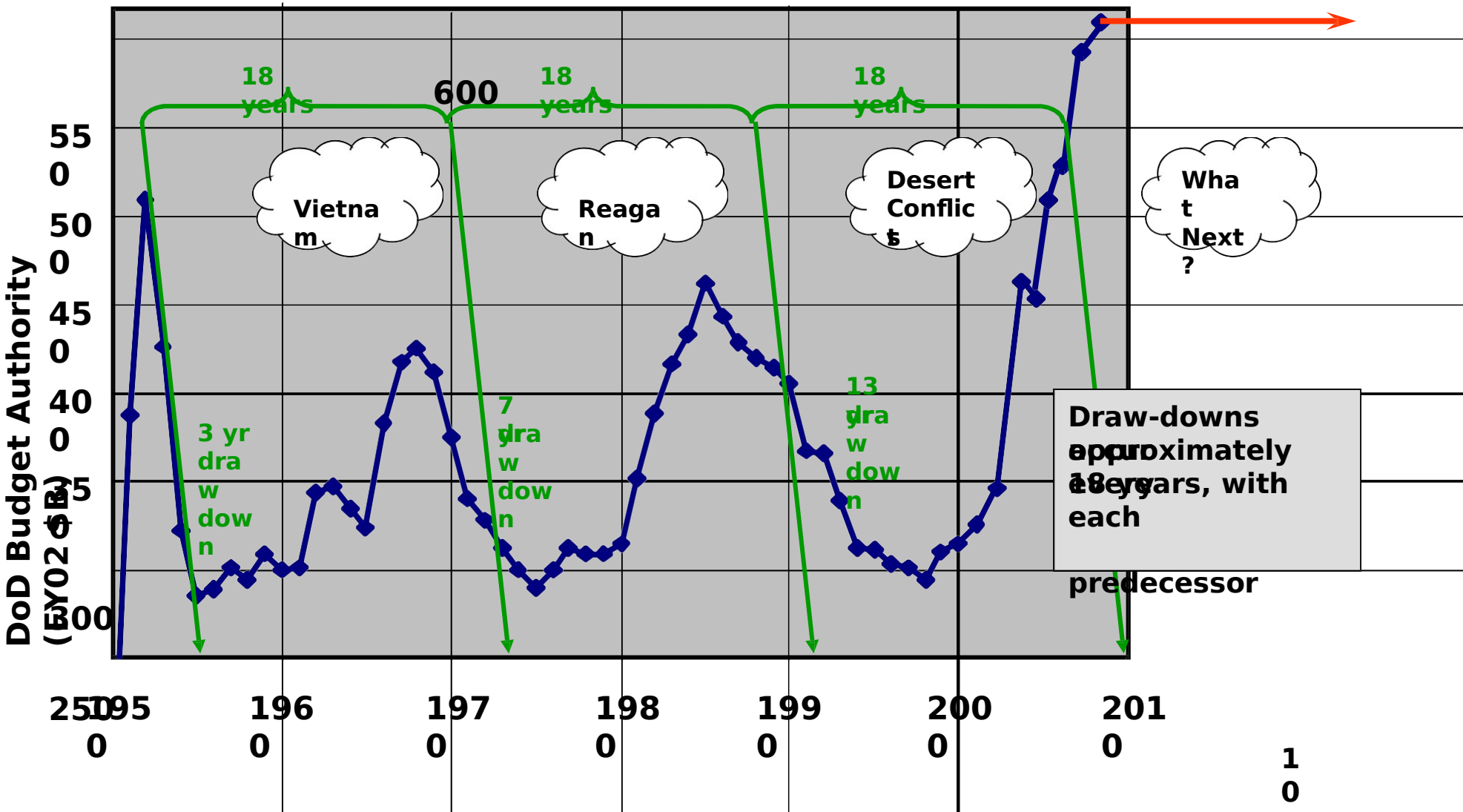
International Markets



- ☑ Markets – potential issues: global corporations; distribution channels. foreign subcontractors
- ☑ US laws & regulations – potential State Dept. issues; technology transfer issues
- ☑ Customs of country – understanding the local customs and traditions
- ☑ Time Zones – communication issues due to different
- ☑ time zones Language – speak the language
- ☑ Logistics – technical specifications different; shipments,
- ☑ spare parts Expanding market of US products – FMS, item increased quantities of s

Cyclical Nature of Defense Budgets

Cyclical market introduces instability and risk to investors



Geopolitical Summary

Global Recession

Continuing War in Middle East

DoD Budget Rebalancing

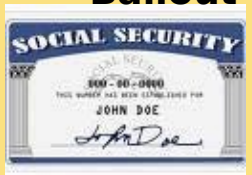
New Administration

Acquisition

Government Bailout

Reform

Budget Crisis
Social Programs



Increasing

New Defense Strategy

Macro Issues that Drives DoD Industry Today

- **Domestic Economics** - Debt, Medicare, Social Security, Supplementals, Trade Balance
- **Threat Changes** - Asymmetric warfare (bio, cyber, IEDs); world-wide terrorism; weapons proliferation; rogue nuclear states
- **New Missions** - Homeland defense; missile defense; counterinsurgency; stability and reconstruction
- **Warfighting Changes** -
- **Technological Changes** - Integrated data; open-sources; bio, nano, robotics, high-energy lasers, etc.
- **Defense Budget Shifts** - From Hardware to Service, Re-set and Homeland Security
- **Globalization** - Rapid spread of Technology; multinational firms; foreign competition
- **DoD Industrial Base** - Adequate programs to support base; align-

COMMERICAL
vs
DEFENSE CONTRACTORS

Commercial vs Defense Contractors

Commercial Business	Defense Business
• Open Markets – Multiple Customers With Individual Transactions – Anti-trust Limits Share Bought • Price-based Business Model – Maximize Sales – Upside/Downside Unlimited – R&D Investments Recouped in Production Price	• Monopsony – Single Customer Comprised of Multiple Constituencies – Industrial Base Policy Model • Cost-based Business Model – Truth in Negotiations Act (TINA) – Maximize Sales – Upside/Downside Capped – R&D Investments Funded or Reimbursed by Government

Commercial vs Defense Contractors

Commercial Business	Defense Business
• Limited Government Oversight	• Significant Government Oversight
• Not Subject to Federal Acquisition Regs	• Subject to Federal Acquisition Regs
• Limited Export Control	• Export Licenses Required to Sell Overseas
• Multi-Year Projections	• Annual Funding
• Consumer Driven	• Government Policy Driven

GOVERNMENT vs INDUSTRY VIEW OF PROFIT

Government vs Industry View of Profit

Government Perspective	
Total Allowable Cost	$9,000,000
Profit/Fee @ 15%	$1,350,000
Price	$10,350,000
Return on Sales	13.04 %

How 15% Yields 6.53%

Defense Contractor Perspective

Sales

$10,350,000 Total Allowable Cost

($9,000,000) Unallowable Cost @ 3% of Sales

($310,500)

Earnings Before Taxes

$1,039,500

Income Taxes @ 35%

($363,825)

Net Income

$675,675

Return on Sales

6.53 %

CASH IS "KING"

Government Contracts

Payment Options

- **Progress Payments**
  - **Applicable only to the fixed-price family of contracts**
  - **Reduce the amount of internal and private financing required to support work-in-process inventory**
- **Performance-Based Payments**
  - **Applicable only to the fixed-price family of contracts**
  - **The basis for performance-based payments may be either specifically described events or**

Cash Flow
Contract and Payment Options

Contract = $150M
Withhold = 20%
Prog Pmt = $120/12 mos.

1st Delivery

1st Article Test

3rd Delivery

Final Delivery

Contract Payment Type	Jl	F Jl	M	A	M		Jl tal	A	S	O	N	D	To	
Cost Plus	3	6	13	15	17	10	18	13	22	15	10	8		
	150													
Fixed Price: Progress Pmt	10	10	10	10	10	10	10	10	10	10	10	10		
	120													
Fixed Price: Perf-Based , or			2				6		3			33		
Event Based Payments			2				0		5			150		20

Cash Flow Management Considerations

What are some ways the government impacts contractor's cash flow?

- **Delays in processing**
- **invoices Award fee**
- **determinations**
- **Delays in executing contract mods Audit delays**

Other ways…..

Cash Flow Summary

- Cash Flow is Critical to Contractors' Survival
- Cash Flow provides Flexibility to Seize Opportunities
- Contract Types, Fee Structures, and Payment Terms have significant impacts on DOD

IMPORTANCE of RATES

What are Rates

- Rates are developed to ensure that ALL costs of doing business are accounted for and recovered.
- Necessary costs of doing business.
- Are properly allocable to each contract that benefits from that cost
- Forward or projected rates are developed by the contractor and approved by the government based on assumptions regarding future work.
- Rates developed for use in government work are subject to review, audit, and approval by Defense Contract Audit Agency (DCAA).
- Recovery of some costs is not allowed (unallowable costs) by FAR.

Calculate Indirect Cost Rates

$$\text{Indirect Cost Rate} = \frac{\text{Indirect Cost Pool}}{\text{Direct Cost Allocation Base}}$$

Rates and Strategic Planning

- Forward or Projected Rates are developed as a part of Strategic Planning.
- Developed for specific fiscal periods, e.g., fiscal year
- They are driven by assumptions made as part of the Strategic Planning effort.
- The exact method of determining rates varies with the company, but must follow generally accepted accounting principles and FAR cost accounting requirements.
- DCAA audits rates used by defense contractors.
- I
competitiveness.

Contractor & Govt Objective --- Stable, Competitive Rates

INDUSTRY MOTIVATORS & INCENTIVES

Industry Drivers

- **Meeting Corporate Financial Objectives**
  - **Growth, reliable cash flow, and maximizing profits**
- **Balancing Risk while delivering the product or service**
- **Revenue Growth – expand the business base (Market Share/Penetration)**
- **Shareholder expectations & the Wall Street Factor**

CHALLENGES for DEFENSE CONTRACTORS

CHALLENGES OF THE U.S. DEFENSE MARKET

TODAY'S CHALLENGES FOR DEFENSE COMPANIES

- Aggressive competition
- Fewer new program starts
- Increasing program cancellations
- Stringent government oversight, regulation, audits and investigations
- High cost of compliance to government contract paperwork requirements
- Government sometimes dictates technical solutions and team members
- Difficult contract provisions
- Corporate and personal

- Survival demands diversification of customer base
- Uncertainty of program requirements

CHALLENGES for GOVERNMENT

Challenges of Government

- Take time to understand the contractor.
- The Ktr understands how to run a business, do you?
- Educate better govt. personnel on business knowledge
  - Impacts negotiations, decision making, effectiveness
  - Really understand a fair and reasonable price
- Have a good grasp of indirect costs, cash flow, financial metrics, risk, and stability of industry

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WHAT IS MOST IMPORTANT TO INDUSTRY?

Important to Industry

GOVT REGS

COSTS

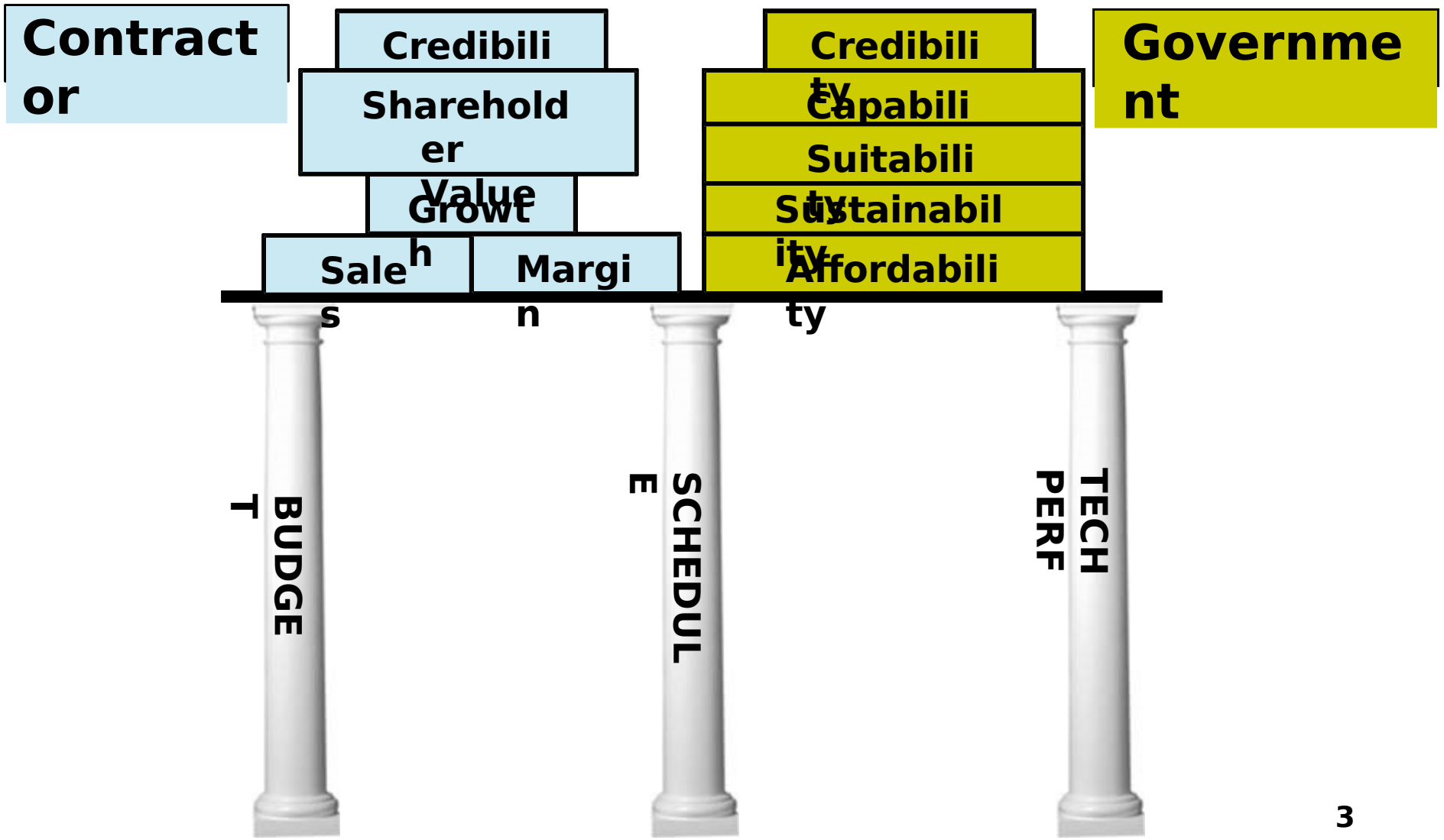
SALES

RISK MGMT

CASH FLOW

MAXIMIZE PROFITS

Common Goals



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Questions???
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